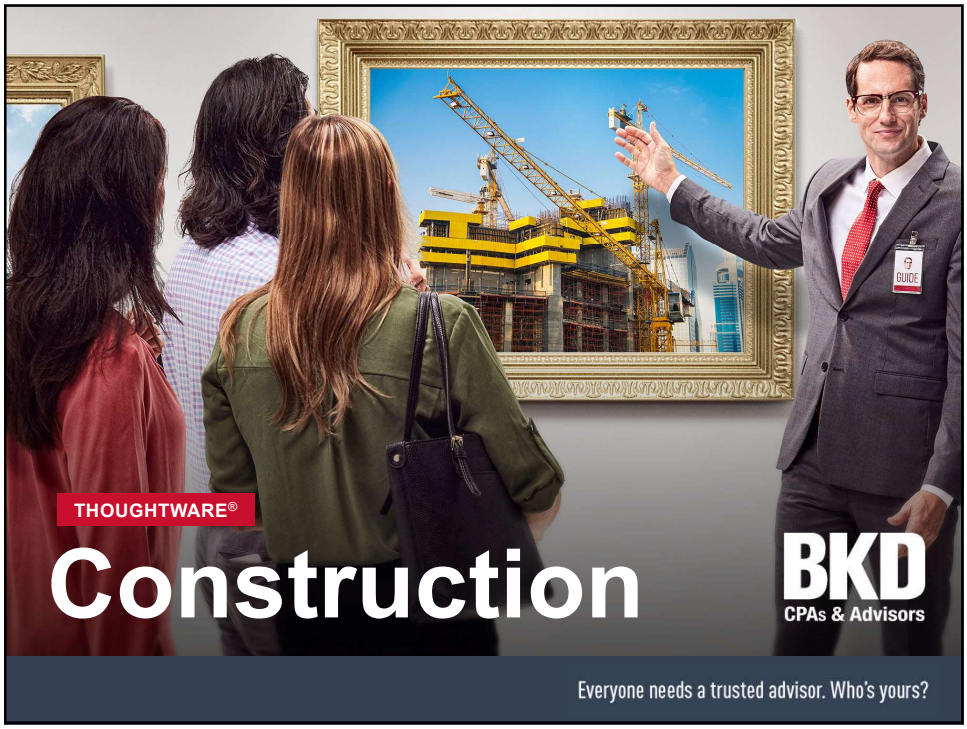
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THOUGHTWARE®
What We've Learned From Tax Reform
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Agenda

- Highlight key items of tax reform
- Bonus depreciation
- Real property trade election
- Pass-through business deduction
- Parking fringe benefits
- Entity structure
- Additional Opportunities

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3

Reduced Corporate Tax Rates

Taxable Income	Previous Law	TCJA
$0–$50,000	15%	21%
$50,001–$75,000	25%	
$75,001–$100,000	34%	
$100,001–$335,000	39%	
$335,001–$10,000,000	34%	
$10,000,001–$15,000,000	35%	
$15,000,001–$18,333,333	38%	
More than $18,333,333	35%	

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Reduced Individual Income Tax Rates

2018	Single Ordinary Rates	2019	
Rate*	Bracket	Rate*	Bracket
10%	$0–9,525	10%	$0–9,700
12%	9,526–38,700	12%	9,701–39,475
22%	38,701–82,500	22%	39,476–84,200
24%	82,501–157,500	24%	84,201–160,725
32%	157,501–200,000	32%	160,726–204,100
35%	200,001–500,000	35%	204,101–510,300
37%	More Than 500,000	37%	More Than 510,300

**Plus 3.8 percent net investment income tax on unearned income when modified adjusted gross income exceeds $200,000 ($250,000)*

Expires after December 31, 2025

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Repealed Corporate AMT

- Permanent repeal for tax years beginning after December 31, 2017
- Remaining alternative minimum tax (AMT) credits refundable
  - 2018–2020 tax years
    - Reduce regular tax liability by any available AMT credit
    - 50 percent of any excess AMT credit is refundable
  - 2021 tax year
    - Any remaining AMT credit carryforward is refundable

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Limited or Eliminated Deductions

- Business entertainment
  - Eliminated 50 percent deduction for amounts paid or incurred after December 31, 2017
  - Amounts for expenses previously fully deductible under specific exceptions are retained
- Business meals for employers
  - Limited deduction for amounts paid or incurred for otherwise allowable food/beverage expenditures to 50 percent
  - Certain exceptions still allow a full deduction

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Limited or Eliminated Deductions

- Business meals for employees
  - Did not change under the TCJA
  - Value of food/beverages provided is excluded from employee's income if it fits into one of these categories
    - Meals provided as a de minimis fringe benefit, *e.g.*, coffee & doughnuts
    - Meals provided at an on-premises, employer-operated eating facility that are considered a de minimis fringe benefit, *e.g.*, a cafeteria
    - Meals provided to employees for convenience of employer at employer's business location, *e.g.*, meal provided to an employee over lunch so he/she is there to take an emergency call

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Expanded Capital Recovery Provisions

- Enhanced bonus depreciation
  - September 28, 2017–December 31, 2022 – 100 percent
  - Reduces by 20 percent per year thereafter through 2026
  - Available for both new & used assets
  - Made changes to qualified improvement property, creating unintended need for technical correction
  - Does not impact accounting for long-term contracts

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Expanded Capital Recovery Provisions

- Expanded §179
  - Up to $1,020,000 for 2019 (adjusted annually for inflation)
  - Phase out beginning at $2,550,000 of assets placed in service for 2019
  - Definition of qualified property expanded to include certain improvements to nonresidential real property, including roofs, HVAC systems, fire protection & alarm systems & security systems

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Modified & Added Loss Limitations

Net Operating Loss (NOL)

- Modified NOL deduction
- Limits deduction to 80 percent of taxable income for losses arising in tax years beginning after December 31, 2017
- May generally not be carried back
- Carried forward indefinitely

Excess Business Loss Limitation

- Limits aggregate deductions attributable to trades or businesses over the aggregate gross income/gain to $255,000 for single filers ($510,000 MFJ) in 2019
- Any excess losses treated as an NOL

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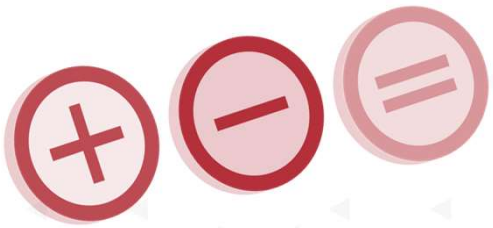
Limited Business Interest Expense

- Deduction generally limited to sum of
  - Business interest income
  - Floor plan financing interest
  - 30 percent of adjusted taxable income (ATI)



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Limited Business Interest Expense

- ATI = taxable income with following adjustments
  - +/- items of income, gain, deduction or loss not properly allocable to trade/business
  - + depletion, depreciation & amortization for taxable years beginning before January 1, 2022
  - + net business interest expense
  - + NOL
  - + QBI deduction

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Limited Business Interest Expense

- Limitation does not apply to
  - Businesses with average gross receipts ≤ $25 million (affiliated group basis)
  - Regulated public utility businesses including electric cooperatives
  - Real property businesses & farming businesses (including agricultural & horticultural cooperatives) may elect not to be subject to limitation provided they use ADS method for depreciation

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Limited Business Interest Expense

- Real property trades can elect out of provision
  - Requires depreciation of residential & nonresidential property under ADS lives (30 & 40 years respectively)
- What trades qualify?
  - Real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing or brokerage trade or business

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Created New 20 Percent Deduction

- New IRC Section 199A provides 20 percent deduction of domestic qualified business income (QBI) for individuals, trusts & estates for 2018–2025 tax years
- When taxable income exceeds $160,700 ($321,400 for joint filers or surviving spouse) in 2019, limitations partially apply until taxable income reaches $210,700 ($421,400)
  - W-2 wages
  - Qualified property
  - Specified service trade or business

Expires after December 31, 2025

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Created New 20 Percent Deduction

- Aggregation options
  - 50% or more common ownership
  - Ownership exists for majority of year including last day of tax year
  - Can't aggregate with an SSTB
  - Must meet two of the following:
    - Businesses are similar or products, property or services are commonly sold together.
    - Centralized business management or facilities
    - Businesses rely upon each other.

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Created New 20 Percent Deduction

- Issues with the wage limitations
  - Guaranteed payments do not count
  - Wages paid by a management company cannot be allocated
  - PEO wages do qualify

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Example 1: Full Deduction

Facts

- Sole proprietorship
- Filing status is single
- Manufacturer of widgets
- No employees
- For tax year ending December 31, 2018
  - Taxable income of $100,000
  - Compensation to owner: $0
  - Qualified business income of $100,000
  - Purchased widget-making machine for $100,000

QBI deduction = $20,000

• 20 percent of QBI		$20,000
• 50 percent of W-2 wages		$0 ($0 x .50 = $0)
• 25 percent of W-2 wages 2.5 percent of unadjusted basis of qualified property	+	$2,500 ($100,000 x .025 = $2,500)

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Example 2: Limited to UBIA

Facts

- Sole proprietorship
- Filing status is single
- Manufacturer of widgets
- No employees
- For tax year ending December 31, 2018
  - Taxable income of $1,000,000
  - Compensation to owner: $0
  - Qualified business income of $1,000,000
  - Purchased widget-making machine for $1,000,000

QBI deduction = $25,000

• 20 percent of QBI	$200,000
• 50 percent of W-2 wages	$0 ($0 x .50 = $0)
• 25 percent of W-2 wages + 2.5 percent of unadjusted basis of qualified property	$25,000 ($1,000,000 x .025 = $25,000)

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Example 3: Limited to Wages

Facts

- S corporation
- Filing status is single
- Manufacturer of widgets
- No employees other than owner
- For tax year ending December 31, 2018
  - Taxable income of $1,000,000
  - Compensation to owner: $100,000
  - Qualified business income of $900,000
  - Purchased widget-making machine for $1,000,000

QBI deduction = $50,000

- 20 percent of QBI — $180,000
- 50 percent of W-2 wages — $50,000 ($100,000 x .50 = $50,000)
- 25 percent of W-2 wages + 2.5 percent of unadjusted basis of qualified property — $50,000 (($100,000 x .25) + ($1,000,000 x .025) = $50,000)

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SCENARIO 1: QBI DEDUCTION

	Previous Tax Law		New Tax Law	
	Corp	S Corp	Corp	S Corp
Business income	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Qualified business income deduction	- -	- -	- -	(200,000)
State income tax (entity level)	(60,000)	- -	(60,000)	- -
Taxable income	*940,000*	*1,000,000*	*940,000*	*800,000*
State income tax (shareholder level)	- -	(60,000)	- -	(60,000)
Federal income tax on business income	(319,600)	(325,623)	(197,400)	(226,499)
Tax on distribution to owner	(184,879)	- -	(221,295)	- -
Total tax	*(564,479)*	*(385,623)*	*(478,695)*	*(286,499)*
Net cash to owner	***$435,521***	***$614,377***	***$521,305***	***$713,501***
Combined effective tax rate	***56.45%***	***38.56%***	***47.87%***	***28.65%***

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SCENARIO 2: NO QBI DEDUCTION

	Previous Tax Law		New Tax Law	
	Corp	S Corp	Corp	S Corp
Business income	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Pass-through business deduction	- -	- -	- -	- -
State income tax (entity level)	(60,000)	- -	(60,000)	- -
Taxable income	*940,000*	*1,000,000*	*940,000*	*1,000,000*
State income tax (shareholder level)	- -	(60,000)	- -	(60,000)
Federal income tax on business income	(319,600)	(325,623)	(197,400)	(300,499)
Tax on distribution to owner	(184,879)	- -	(221,295)	- -
Total tax	*(564,479)*	*(385,623)*	*(478,695)*	*(360,499)*
Net cash to owner	***$435,521***	***$614,377***	***$521,305***	***$639,501***
Combined effective tax rate	***56.45%***	***38.56%***	***47.87%***	***36.05%***

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SCENARIO 3: RETAIN 50% OF INCOME

	Previous Tax Law		New Tax Law	
	Corp	S Corp	Corp	S Corp
Business income	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Pass-through business deduction	- -	- -	- -	- -
State income tax (entity level)	(60,000)	- -	(60,000)	- -
Taxable income	*940,000*	*1,000,000*	*940,000*	*1,000,000*
State income tax (shareholder level)	- -	(60,000)	- -	(60,000)
Federal income tax on business income	(319,600)	(325,623)	(197,400)	(300,499)
Tax on distribution to owner	(92,440)	- -	(110,647)	- -
Total tax	*(472,040)*	*(385,623)*	*(368,047)*	*(360,499)*
Net cash to owner	217,760	114,377	260,653	139,501
Net cash retained in business	310,200	500,000	371,300	500,000
Total net cash after taxes	***$527,960***	***$614,377***	***$631,953***	***$639,501***
Combined effective tax rate	***47.20%***	***38.56%***	***36.80%***	***36.05%***

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Created New 20 Percent Deduction

- Additional resources available at **bkd.com/taxreform**
  - "Pass-Through Business Deduction" flowchart
  - "The Qualified Business Income Deduction Under the *Tax Cuts and Jobs Act*" white paper
  - "Simply Tax" podcast
    - Episode 54: "Putting the §199A Pieces Together"
  - Webinars
    - "The QBI Deduction: Insights on the Latest Guidance"

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Limited or Eliminated Deductions

- Fringe benefit deductions
  - Qualified transportation fringe benefits not deductible
  - Employee reimbursed moving expenses not excludable from employee income

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Entity Choice Options

- Why be a C corporation?
- Why be an S corporation?
- Why be a partnership?

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Added Qualified Opportunity Zones

- **Qualified opportunity (QO)**
  - **Zones**: low-income census tracts identified by stats
  - **Fund**: corporation or partnership that invests in QO zone property
- Businesses with substantially all tangible property owned or leased in QO zone
- Cannot be golf course, country club, gaming, etc.

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Added Qualified Opportunity Zones

Temporary Deferral of Gain

- 180-day reinvestment of gain directly in fund
- Deferral ends on earlier of date of next sale, or 2026
- Percentage of deferred gain recognized depends on length of holding period
  - < 5 years: **100 percent**
  - > 5 but < 7 years: **90 percent**
  - > 7 years: **85 percent**

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Questions?

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